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SUBJECT: MCC CHIEF EXEC VISITS LESOTHO

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1. SUMMARY: Millennium Challenge Corporation (MCC) Chief Executive Officer (CEO) Paul Applegarth and other MCC officials visited Lesotho October 25-26 on a familiarization trip. In an extremely busy 36 hours, Mr. Applegarth and his team met with a wide variety of government, private sector, NGO, and donor representatives, as well as making three site visits, including one for a project featured in the Compact proposal. Ambassador Perry hosted private sector and NGO representatives as well as the Ministers of Foreign Affairs, Finance, Tourism, Natural Resources and Agriculture at the CMR for receptions and luncheon discussions with the MCC team. In addition, Embassy Maseru Pol/Econ and Public Diplomacy staff organized donor and public affairs events for the MCC/CEO and delegation members at the Chancery. The Government of Lesotho held a final reception in honor of the CEO and his team. Prior to the visit, the Ambassador, accompanied by DCM, briefed key GOL officials (including the Prime Minister) on the familiarization rather than technical nature of the trip. The Lesotho program accomplished the team's goals and provided a reciprocal benefit to government officials and others involved in Compact process, who had a much-appreciated opportunity to meet senior MCC leadership and learn more about the MCC's approach to evaluating proposals. END SUMMARY.

2. On October 25-26, MCC/CEO Paul Applegarth visited Lesotho to learn more about potential partners here in an MCC Compact and to familiarize himself with the the overall economic and political environment. Accompanying him were: John Hewko, MCC Vice President, Country Relations; Maureen Harrington, Senior Advisor; and Kristen Herring, Press Assistant. (Note: Lesotho is one of the 16 countries declared eligible to compete for the USD 1 billion in MCC funds allocated for FY 2004. The government submitted a draft Compact in late September, requesting a total of USD 254 million. The purpose of the trip was not to provide detailed technical feedback on the proposal.) The team met with a wide variety of persons and organizations involved in drafting the Compact or with a strong interest in the MCC's final decision. Activities included:

Meetings with:

Prime Minister Pakalitha Mosisili;
Minister of Foreign Affairs Kenneth Tsekoa;
Minister of Natural Resources (Mr.) Monyane Moleleki;
Working breakfast -- Home Affairs and Public Safety Tom Thabane;
Chief Executive of the Lesotho Highlands Development Authority,
(Mr.) E.L. Potloane;
(Combined) the Cabinet MCA Sub-Committee, the Principal Secretaries' Steering Committee,

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and the technical working group;
Donor community representatives.

Other Events:

Ambassador hosted CMR working lunch with NGO representatives;
working lunch with Cabinet sub-committee, i.e., ministers of foreign affairs, finance and development planning, agriculture and food security, natural resources, and tourism, environment, and culture; and a reception for private sector representatives;
Econ/Comm Assistant organized site visits to Lesotho Flour Mills, (U.S. investment) and Global Textiles and Formosa Textiles (AGOA-related investments) and a visit to proposed site of the Metolong Dam, featured in Lesotho's MCC proposal; and,
Public Diplomacy Officer hosted Press event for local media.

Ambassador Perry and DCM Albrecht accompanied the team on all meetings/events. In addition, Public Diplomacy (PD) Officer Dornburg, GSO Blosser, and Econ/Commercial Assistant Akhionbare participated in most activities as did PD Assistant Nthejane.

Meeting with MFA

3. Mr. Applegarth's visit began with a call on MFA Tsekoa. The CEO stressed, as he did in all subsequent conversations, that the purpose of the visit was familiarization with those individuals and groups involved in drafting the Compact, i.e., the potential partners with the MCC, should a final agreement be reached. The team would not and could not provide detailed

feedback on the recently-submitted draft Compact. In response, Tsekoa noted the wide-ranging participation in the drafting

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process both within and outside of the government which had resulted in a strong sense of "ownership" of the proposal. Priorities (development of water resources, agriculture, industrialization, tourism, and institutional capacity building) had been selected carefully. Another strong plus for Lesotho was its continuing progress on democratization: free and fair national elections in 2002, upcoming local elections (note: planned for sometime before March 31, 2005, but no specific date has been announced, end note) and the country's participation in the AU African Peer Review Mechanism.

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14. Describing the Compact as "thoughtful and comprehensive," Mr. Applegarth said he hoped to get a better understanding of the proposal's implementation and its links to poverty reduction and employment creation. He added that the MCC is preparing to select eligible countries for 2005 and Lesotho is a candidate. In response to a question from Tsekoa, he reassured the MFA that eligibility in 2004 would not reduce a country's chances for 2005. Lesotho, in fact, does well under the two changed eligibility criteria: reduction in the inflation rate ceiling from 20 to 15 per cent and female, as opposed to overall, primary school completion rate.

----- NGO's Provide Their Views -----

15. At the Ambassador's lunch with representatives of the NGO community, CEO Applegarth solicited views about the consultation process regarding the Compact and the proposal's priorities. NGO's generally thought the consultations had been open and genuine, with civil society's views receiving due consideration. There was some disagreement on priorities. The proposed ski resort, for example, did not match the Millennium Challenge Account (MCA) Tourism Task Force's recommendation to develop eco-tourism. A CARE employee and a local consultant questioned how much the population would benefit from the three proposed dam projects in the Compact. A representative from Habitat for Humanity raised the long-standing problem of land tenure -- the current system prevents owners from having clear title. The Lesotho Council of NGO's noted that statistics in Lesotho are often unreliable -- to which Applegarth commented that data collection may need to be a part of the first state of any implementation plan. He encouraged NGO's to remain engaged in the consultations process, which would continue as part of efforts to develop an implementable Compact.

----- Cabinet Sub-Committee, PS Steering Committee and Others -----

16. At the Prime Minister's request, the GOL arranged a combined meeting for the team with the Cabinet MCA Sub-Committee (ministers of foreign affairs, finance and development, agriculture and food security, and tourism, environment, and culture), the Principal Secretary Steering Committee (members from the same ministries as the Cabinet group), and representatives of the technical working group, which included NGO and private sector officials. Minister of Finance Thahane noted that groups involved in creating the Vision 2020 national plan and the Poverty Reduction Strategy Paper also worked on the MCA document. The Minister made four major points:

- 1) The proposal's formulation was inclusive and would continue to be so.
- 2) The private sector should be the engine of development, requiring the government to create an attractive business environment; government would engage the private sector on how to create such an environment and what sectors are best for development.
- 3) The government is addressing the need to improve administrative and financial management.
- 4) Development in Lesotho should be based on the resources available: people and water.

17. Applegarth described MCA as part of the overall USG approach to development, which consists of trade, debt relief, and development aid. MCA is an investment of U.S. taxpayer money in poverty reduction and economic growth, based on a partnership model. By 2006, MCA would be the largest U.S. aid program since the Marshall Plan, assuming full funding. Turning to Lesotho's proposal, he described the document as "thoughtful," and based on the resources available in the country. The consultative process seemed to be appropriately inclusive.

18. Discussion then focused various aspects of the proposed

Compact. In response to questions about when a proposal might be approved, Applegarth declined to be specific, but said he would be disappointed if nothing was in place by the middle of next year. To help move things along, he suggested that those responsible for the Compact consider: phased-in implementation; other funding sources, as MCA would assist other donors; implementation by non-government entities; and what types of policies require assistance that MCA could provide. Hewko stressed the importance of measurable results, tangible outcomes that do not involve merely materials or equipment.

Minister of Natural Resources

19. Minister Moleleki concentrated on describing the Metolong Dam project featured in the Compact. Lesotho is requesting USD 43

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million from MCC for the USD 115 million total project intended to provide water for residential and industrial use in the greater Maseru area. Metolong is a fast-track project; according to the Minister; ground-breaking could occur in June of July of 2005, if funding is available soon. (Note: an environmental impact assessment, however, remains to be done.)

LHDA Director Potloane

10. The MCC team met with Potloane to see what lessons learned from the Lesotho Highlands Water Project might apply to the water projects proposed in the Compact. (Note: the LHWP currently consists of two dams in central Lesotho which supply water to South Africa, generating between USD 2 to 2.5 million per month in revenue, at current rates, and generating all of the electricity requirements for the national grid. Proposed additional dams are undergoing feasibility studies.) Potloane felt that the management and engineering skills developed among Basotho during the design and construction of LHWP would be used on the lowlands projects in the Compact. While he praised the overall proposal, Potloane stated several areas needed further attention: a suitable organizational structure for water distribution; improved water resource management legislation; and careful selection of funding sources (South Africa covered 90 per cent of the cost of the LHWP).

Site Visits

11. The team visited Lesotho Flour Mills, 50 per cent owned by U.S. company Seaboard Corporation and the only significant U.S. investment in Lesotho, as well as Global Garments and Formosa Textiles, two Taiwan-owned AGOA-based enterprises. At the flour mill, Acting Managing Director Daniel Awani (who previously managed some Seaboard operations in West Africa) described the business environment in Lesotho, both in general and sector-specific terms. Some of the problems he cited result from Lesotho's situation as a landlocked country within a country with a stronger economy. For example, the mill imports 90 per cent of its raw materials by rail through South Africa. Although the company is situated within easy reach of the grain producing area of South Africa, the rail system in South Africa is not reticulated in a manner that allows the mill to take advantage of proximity to surrounding farms. He said such difficulties could be resolved through the rationalization of transport routes by the Lesotho and South African governments. Processing procedures at the South Africa - Lesotho border are slow and should be streamlined.

12. Regarding labor, the mill is able to attract good quality workers in Lesotho, but faces stiff competition from South Africa, which offers much higher salaries. The laws governing employment in Lesotho tend to be overprotective towards workers, leading to protracted litigation which impacts on swift disciplinary action by employers. Lesotho banks operate against lending ceilings that are below the requirements of large operators like the mill. The government bureaucracy governing licenses, work permits etc. tends to be slow, but the mill has not detected any corruption in its dealings with the authorities. Similarly, the company felt that the court systems operates in a transparent and fair manner.

13. Global Garments is one of three factories owned by Nien Hsing, a Taiwan-based investor. It manufactures denim garments for export to major United States retailers such as the GAP, including Old Navy, and Walmart. Global has been operating for the past eighteen months, and employs 2,500 workers. The company currently imports fabric from the Far East, but will start using cloth from Formosa Textiles, a sister fabric mill based in Maseru. Nien Hsing operations in Lesotho employ a total of 9,000 workers including those at Formosa as well as another production site. Factory management felt the government has

generally been helpful in meeting its needs, e.g., infrastructure, water supply, etc., although the electrical supply is unstable at times. Formosa is operating at significantly below capacity, due, its owners claim, to the extension of the AGOA third country fabric provision which allows clothing makers to continue importation of inexpensive fabric from Asia.

14. The proposed site for the Metolong dam lies about 35 kilometers east of Maseru. Representatives of the Ministry of Natural Resources and the Water and Sewage Authority who accompanied the team stressed the minimal disruption of the project to the surrounding area. No villages would need to be relocated and the water level would not flood existing fields. When filled, the dam would meet the anticipated needs of the Maseru area and still have ample spare capacity.

Lunch with Cabinet MCA Sub-Committee

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15. At a lunch hosted by the Ambassador, MFA Tsekoa acknowledged the need to delineate priorities and phases in Lesotho's proposal. CEO Applegarth commended Lesotho's culture of openness and transparency described by various persons/organizations the team had already met. He encouraged consideration of an expanded resource model in Lesotho to include highland water, Basotho people, the NGO community, private sector, and donor organizations. Minister of Finance Thahane expressed concern about the withdrawal of training by cooperative partners in the U.S. over the past 10 years. He underlined the ambiguity of the term "capacity building" and called for integration of specific skills development into the proposal. Despite admitted frustration at "talent poaching" by South Africa, Ministers Phororo (Agriculture) and Mololeki (Natural Resources) suggested resurrecting agro-economic, management, and financial exchange opportunities such as the former programs with Washington State University and the state of Colorado. The ministers also illuminated for the MCC team the nuanced displacement of highland for lowland Basotho values, or a cattle-as-collateral to cattle-as-commodity shift amidst increased stock theft and land use disputes. There remains some sentiment for eventual development of tourist sites as noted by Minister Nts'inyi who also commented on the recent international tourism conference she attended in Washington, D.C. The Government of Lesotho as a whole is eager for feedback on a proposed Compact and for the next MCC team visit.

Meeting with Donors and Press Event

16. At the meeting with approximately 20 representatives of the donor community, Applegarth outlined the basics of Lesotho's proposed Compact. (Knowledge of the proposal among the donors varied considerably.) He stressed that MCA is an addition to the other donor initiatives. MCC would be happy to collaborate with other donors in worthwhile projects planned or underway. He added that the consultative process seemed to have been valid and genuine. Donors commented that the consultations required by MCA had significantly improved intra-governmental communication and the GOL's outreach to other sectors. One of the most experienced diplomatic representatives added that the current environment is the best ever for getting a return on one's investment in development. This event, held at the Embassy, was followed by a press conference covered by national television and print media including the country's leading news magazine.

Meeting with Prime Minister

17. PM Mosisili praised the MCA as holding out great potential for Lesotho. MCA is one of numerous USG initiatives (e.g., AGOA) that engage and involve the beneficiary country and, in the process, gain the support of the general population. Lesotho's progress in democratization has opened up society, he added; the successful 2002 elections brought a peaceful post-election period for the first time in the country's history. This provides an opportunity to tackle development issues. In that regard, the Compact's priority on building the water sector is appropriate. The LHWP is a good example of how the country can benefit from exploiting its water resources. Mosisili agreed with Applegarth's suggestion about the need for all parties involved in the Compact to consider implementation options, refine indicators of success, and continue to work on policy development. He volunteered that the time required to start a business in Lesotho (an indicator where Lesotho ranks below the median among MCA eligible countries) must be reduced.

Regardless of these issues, the Prime Minister concluded, Lesotho would continue to provide its people and investors honest government and respect for human rights. During the GOL's Oct 26 reception, the finance Minister reiterated Lesotho's gratitude for the visit and the opportunity to exchange views with the team.

18. COMMENT: Although the team's actual time in Lesotho amounted to little more than 36 hours, the visit accomplished its objectives. The wide range of meeting and other activities familiarized CEO Applegarth and his colleagues with the potential partners in an MCC Compact and with the general political and economic environment. From the perspective of the partners, the familiarization was reciprocal. Meeting top level MCC officials provided a greater understanding of the organization's focus and direction, as well as the general Compact evaluation process. The hosts would have appreciated more feedback on the proposed Compact, which was not possible at this time. Their eagerness for MCC's reaction and receptivity to Applegarth's suggestions for work to be done in the interim

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underscored the commitment of Lesotho to the MCA process. We believe the GOL would work closely with any future MCA technical teams to refine proposed projects and would insure continued dialogue with the multiple constituencies engaged to date.

PERRY